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U.S. TREASURY DEPARTMENT CALLS FOR OVERHAUL OF INSURANCE REGULATION

The U.S. Treasury Department's *Blueprint for a Stronger Regulatory Structure* (the "Blueprint"), released on March 31, 2008, includes many recommendations for changes to the regulation of financial services, including sweeping recommendations calling for the federal regulation of insurance.

Noting that insurance regulation is almost wholly state-based, with over fifty regulators, the Blueprint calls for an Optional Federal Charter ("OFC") for insurance companies, an Office of National Insurance ("ONI") and an Office of Insurance Oversight ("OIO") within the Treasury Department.

Echoing a theme that has accompanied calls for federal regulation in recent years, the Blueprint observes that:

The lack of uniformity across state insurance regulation can lead to inefficiencies and undue regulatory burden, and can directly limit insurers' ability to compete across state boundaries and international borders. This ultimately diminishes the quality of services and consumer choice and can result in higher prices for insurance consumers. . . . State insurance regulatory standards vary from state to state, and are sometimes conflicting. Having the functional regulation of a major national financial services industry such as insurance rest in a fragmented and non-uniform state-by-state regulatory system is unique to the United States. Other developed countries have consolidated insurance regulatory regimes and some have moved to a single consolidated regulator for all financial institutions.¹

Optional Federal Charter

The Blueprint recommends that an Optional Federal Charter ("OFC") be authorized by Congress to be issued by a newly established Office of National Insurance ("ONI"). An insurance company would select the option of federal or state regulation. It appears that the Blueprint looks upon this proposal as transitional:

Such a dual federal-state regulatory structure would allow the new ONI time to integrate current portions of the state-designed body of regulation into the new national system without causing major disruptions to the marketplace.²

1. Blueprint, pps. 127-128.
2. Blueprint, p. 128.

While a federal regulatory structure would provide for a system of federal chartering, licensing, regulation and supervision for insurers, reinsurers and agents and brokers³, according to the Blueprint, legislation establishing the ONI:

...would also provide that the current state-based regulation of insurance (authorized by the McCarran-Ferguson Act) would continue over those not electing to be regulated at the national level. States would not have jurisdiction over those electing to be federally regulated. However, insurers holding an OFC could still be subject to some continued compliance with other state laws, such as state tax laws, compulsory coverage for workers' compensation and individual auto insurance, as well as requirements to participate in state mandatory residual risk mechanisms and guarantee funds.⁴

The Blueprint identifies the need "to integrate current portions of the state-designed body of regulation into the new national system" as a step toward addressing the issue of the "lack of uniformity across state insurance regulations." The Blueprint falls short, however, of eliminating lack of uniformity by permitting insurers to opt for state regulation and by continuing state regulation of workers' compensation, auto insurance, residual risk mechanisms and guarantee funds. Perhaps the goal of the Blueprint is to allow a shakedown period to permit insurers to determine whether they prefer a shift to a federal regulatory scheme.

The OFC would specify the lines of insurance that each national insurer would be permitted to sell, solicit, negotiate, and underwrite.

Office of National Insurance

The Blueprint recommends the creation of an Office of National Insurance ("ONI"), to be established within the Treasury Department and modeled on the Office of the Comptroller of the Currency. The Blueprint envisions the ONI as follows:

It should be headed by a Commissioner of National Insurance ("CNI"), *should be self-funded by assessments imposed on federally chartered insurers*, and should be subject to oversight by the appropriate congressional committees. Treasury believes that such an ONI should be in a position to promote regulatory cooperation and consistency between federal and state regulatory structures. The CNI should be empowered to address international issues with other national regulators, both in terms of comity (e.g., facilitating international firms' operations in the United States) and competitiveness (e.g., facilitating U.S. firms' operations abroad) a role currently beyond the scope of the state-based system.⁵ (emphasis added)

The Blueprint details the federal regulatory powers of the CNI, including the broad powers that currently reside with state insurance regulators. Among the proposed powers are:

3. In addition to this discussion of federal chartering and licensing of agents and brokers, this Alert discusses another pending proposal to reform non-resident insurance producer licensing. See "House Considers Non-resident Insurance Producer Licensing Reform" below.
4. Blueprint, p. 129.
5. Blueprint, p. 131.

In the enforcement area, the CNI should have the power to revoke or restrict a national insurer's federal charter for conduct that is hazardous and represents an undue risk to policyholders, violates any law, regulation, or written agreement, or that is inconsistent with the continuation of existing operations. The CNI should also have the power to establish a receivership for a national insurer for the purpose of rehabilitation or liquidation, as deemed to be appropriate.⁶

Office of Insurance Oversight

In a move to jump start a potential shift of authority to the federal government in the insurance regulatory realm, the Blueprint calls for the immediate creation of an Office of Insurance Oversight ("OIO"). With a focus on international regulatory issues, the OIO would address key areas of federal interest in the insurance sector before a federal regulatory structure is created. The Blueprint envisions the functions of the OIO as follows:

The OIO should become the lead negotiator in the promotion of international insurance policy for the United States, and should have the benefit of consulting with the NAIC and state insurance regulators, who should still be primarily responsible for implementing international regulatory agreements. *However, if the NAIC and state insurance regulators were unable to achieve the needed uniformity in implementing the declared U.S. international insurance policy goals, the OIO should have authority to preempt inconsistent laws or regulatory actions of any state and assume an implementation role as to those matters.* This model of preemption was used successfully in the GLB Act when Congress authorized the creation of a new non-profit entity to adopt uniform licensing standards for insurance agents or brokers if a prescribed number of states failed to adopt a uniform approach of their own.⁷ (emphasis added)

The Blueprint calls for OIO's statutory powers to be transferred to the ONI once ONI becomes operational but to retain a policy apparatus to serve in an advisory capacity to the Secretary of the Treasury.

What Lies Ahead

As has been the case with previous proposals for the federal regulation of insurance, including pending bills in the House and Senate calling for an OFC and an ONI,⁸ initial reaction from various segments of the insurance industry has ranged from wholehearted support to total condemnation of the Blueprint's proposals. The NAIC was quick to condemn the proposal, stating in its March 31, 2008 Press Release that:

"We agree that federal action to look at system risk is long overdue. We agree that the federal government needs to remodel their financial regulatory house, but they need to leave the insurance "room" alone!"

6. Blueprint, p. 132.

7. Blueprint, p. 133; NAIC is the National Association of Insurance Commissioners; GLB is the Gramm Leach Bliley Act.

8. The National Insurance Act of 2007, H.R. 3200, 110th Congress (2008), and the National Insurance Act of 2007, S. 40, 110th Congress (2008), would create an OFC and establish an ONI.

While we certainly support better coordinating and modernizing of their oversight efforts, “Modern” does not mean “Federal.” State insurance regulators are marginalized in this report and, frankly, for our sector it looks more like a solution in search of a problem.

State insurance regulators are accused of inefficiencies in oversight, but we need look no farther than Hurricane Katrina to see how well federal solutions serve the nation.”⁹

Speaking at a program on Current Issues in Insurance Regulation at the New York City Bar on April 4, 2008, moderated by Francine Semaya, New York Insurance Superintendent Eric Dinallo had a strong reaction to the Blueprint, as reported by National Underwriter:

The Treasury Department’s blueprint report “almost shocked me, and that is from someone who has had a lot of shocks in the last few weeks,” quipped Eric Dinallo, New York insurance superintendent, who was appointed to his post by Eliot Spitzer. “If the federal government wants to wade into car and homeowner’s insurance, go right ahead.” Dinallo said he is skeptical about giving insurers and others the option of choosing their regulators, but he noted that he is not strongly opposed to federal involvement in areas such as reinsurance. At the state level,” we have to do better with mechanics,” by continuing to work on projects such as the Interstate Insurance Products Regulation Commission, Dinallo said.¹⁰

Pennsylvania’s Acting Insurance Commissioner, Joel Ario, also speaking at the New York City Bar program,

...pointed out that state and federal regulators already work together to oversee the health insurance market. Life insurers can make the strongest case for federal regulation, but the situation is different in the property-casualty market, because so many products there are tailored to fit the needs of individual regions, Ario said. Ario argued that the worst case would be to give insurers and others a choice between state and federal regulation. Giving regulated entities the option of choosing their regulators would lead to efforts to exploit any differences between the federal and state systems, Ario said.¹¹

Contrast the regulators’ response with the American Insurance Association (“AIA”), which supports the Blueprint:

The inclusion of an ‘Optional Federal Charter’ for insurance, as outlined in the Treasury blueprint, is a major milestone in that it recognizes the important role that the insurance industry now plays in this new financial world of integrated and interconnected markets.

Providing insurers with the option of a single regulator for insurance will benefit consumers and will be more efficient, effective and rational given the ‘increasing tension’ a state-based regulatory system creates.¹²

The Independent Insurance Agents and Brokers of America (the “Big I”) spoke in opposition to the insurance regulatory aspects of the Blueprint:

9. *NAIC Response to Treasury Report, Statement from NAIC President Sandy Praeger*, available at www.naic.org.

10. *Regulators Defend the Current System by Jim Connolly*, National Underwriter Online News Service, April 8, 2008.

11. *Id.*

12. Statement of Marc Racicot, President of AIA, available at www.aiadc.org.

While there may be some merit in the role envisioned for the Fed to identify and facilitate corrections of systemic problems in the financial services industry, the OFC section of the blueprint is clearly swimming upstream . . . It's hard to see Congress supporting a proposal that calls for massive deregulation of the industry and a huge new federal bureaucracy.¹³

There is no question that the current state insurance regulatory system needs to be reformed and modernized and there may well be a place for federally chartered life insurers and reinsurers.

HOUSE RECONSIDERS NON-RESIDENT INSURANCE PRODUCER LICENSING REFORM

The U.S. House recently introduced legislation that would revive an effort to create a self regulatory organization to retool out-of-state insurance producer licensing requirements. H.R. 5611, introduced on March 13, 2008, would provide for the establishment of the National Association of Registered Agents and Brokers ("NARAB"), a nongovernmental and nonprofit corporation created to:

provide a mechanism through which licensing, continuing education, and other insurance producer qualification requirements and conditions can be adopted and applied on a multi-state basis, while preserving the right of States to license, supervise, and discipline insurance producers, and to prescribe and enforce laws and regulations with regard to insurance-related consumer protection and unfair trade practices.¹⁴

A prior incarnation of the NARAB proposal existed as an initiative under the Gramm-Leach-Bliley Act of 1999 ("GLBA")¹⁵ to streamline certain insurance regulatory processes. Under the GLBA, twenty-nine states and U.S. territories were required to enact reciprocal, uniform insurance producer licensing laws by 2002. If the minimum number of states failed to meet the requirements by enacting reciprocal licensing laws, NARAB would have been created at that time.

In response to the mandates under the GLBA for NARAB's creation, the National Association of Insurance Commissioners ("NAIC") and the various state insurance departments worked to implement the reciprocity standards of the GLBA and avoid relinquishing states' authority over the licensing process. The NAIC issued a Declaration of Reciprocity to state insurance regulators in 2000, setting forth the key licensing reciprocity mandates of the GLBA. By the deadline for compliance, the NAIC had certified that thirty-five states had implemented the licensing reciprocity mandates of GLBA,

13. Statement of Bob Rusbuldt, President of the Independent Insurance Agents and Brokers of America, available at www.independentagent.com.

14. National Association of Registered Agents and Brokers Reform Act of 2008, H.R. 5611, 110th Congr. § 322 (2008).

15. Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (November 12, 1999).

thus exceeding the threshold and avoiding implementation of the NARAB initiative. Following the NAIC's initial certification that thirty-five states meet the reciprocity mandates of GLBA, an additional eight states have been deemed to meet the reciprocity mandate of GLBA, bringing the total of certified reciprocal states to forty-three.¹⁶

The Congressional legislation proposed in March of 2008, entitled the "National Association of Registered Agents and Brokers Reform Act of 2008," would revive NARAB.

The latest NARAB proposal has the support of both the Independent Insurance Agents & Brokers of America (the "Big I") and the National Association of Insurance and Financial Advisors ("NAIFA"). The Big I and NAIFA's support of this measure comes, in part, because the trades anticipate that the NARAB proposal will reduce or eliminate what they deem to be unnecessary and duplicative non-resident licensing requirements, allowing "producers who are licensed and operate in multiple states to comply with a single set of licensing and continuing education rules"¹⁷, and achieve "a much needed reciprocity in producer licensing."¹⁸

The reception of the proposal by state insurance regulators has been far less welcoming. New Hampshire Insurance Commissioner Roger Sevigny, president-elect of the NAIC, expressed concerns that the NARAB proposal would give an inordinate amount of power to insurance lobbying groups, as the majority of NARAB Board of Directors would be appointed by insurance trade associations. He further posited that the proposal fails to recognize the progress made by states to date in bringing reciprocity and uniformity to the insurance producer licensing process.¹⁹

At its most recent Spring National Meeting in Orlando, Florida, the NAIC's NARAB Working Group, which is charged with, *inter alia*, evaluating the reciprocity status of states, evaluating the reciprocity standard developed in 2002, and providing recommendations for simplifying and standardizing business entity licensing process, reviewed the effect of certain issues relating to GLBA reciprocity. Among such issues were: underlying life license requirements prior to the issuance of a non-resident variable life licenses; verification of legal work authorization for non-resident applicants who are non-U.S. citizens; license or appointment requirements for the designated

16. The following states have been certified by the NARAB Working Group: Alabama, Alaska, Arizona, Arkansas, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. The NAIC Legal Division has reviewed and recommended that Montana and the District of Columbia be deemed to meet the reciprocity requirements. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, NAIC PRODUCER LICENSING ASSESSMENT AGGREGATE REPORT OF FINDINGS (February 19, 2008).
17. Press Release, National Association of Insurance and Financial Advisors, NAIFA Welcomes Introduction of Interstate Insurance Agent Licensing Bill (March 13, 2008), http://www.naifa.org/newsreleases/20080313_narabII.cfm .
18. Press Release, Independent Insurance Agents & Brokers of America, Big "I" Applauds Introduction of NARAB Reform Act, (March 13, 2008), http://www.iiaba.net/na/02_News/02_PressRelease/NA20080314103300?ContentPreference=NA&ActiveState=0&ContentLevel1=NEWS&ContentLevel2=NEWSPRESS&ContentLevel3=&ActiveTab=NA&StartRow=0.
19. *As Congress Weighs Reciprocal Licensing, Regulators Tout Progress*, BestWire, March 24, 2008 06:09 A.M., available at <http://www3.ambest.com/frames/frameserver.asp?site=news&tab=1&AltSrc=14&refnum=113642> (subscription required).

responsible producers prior to the issuance of a non-resident business entity license; articles of incorporation submission requirements for non-resident business entities; requirements that individuals seeking a fraternal non-resident license have an accident/health license and have a fraternal certificate from a company; non-resident versus resident producers license renewal discrepancies, and verification that applicants for non-resident license renewal have paid all undisputed taxes and unemployment insurance contributions.

H.R. 5611 has been referred to the House Committee on Financial Services as the NAIC working group continues its work analyzing the preceding issues. Among the issues that must necessarily be considered as part of the House Committee's deliberations on the NARAB proposal is a constitutional question: whether a private, nongovernmental entity can lawfully preempt individual states' regulatory schemes. Put another way, does the legislation creating NARAB sufficiently relate to the business of insurance so as to preempt state insurance regulation in accordance with the provisions of the McCarran-Ferguson Act?²⁰ Or, does H.R. 5611 merely create an nongovernmental entity to engage in producer licensing, but fail to impose sufficient regulatory requirements to preempt state regulation? If H.R. 5611 is not in accord with McCarran Ferguson, could the creation of such a nongovernmental entity be construed as the Federal government trying to do indirectly (preempt state insurance regulation) what it otherwise cannot do directly?

Additional inquiry may be warranted into whether this purported grant of preemptive authority would involve a permissible delegation of powers to a nongovernmental entity. Furthermore, due consideration must be given to the effect of having an additional, optional licensing process. Because membership in NARAB would be optional for producers, whereas state licensure is compulsory to do the business of insurance, will the dual processes prove to be chaotic?

20. 15 U.S.C. 1012.

If you would like more information on this or any other insurance, reinsurance or insolvency regulatory actions, please feel free to contact Francine L. Semaya, Esq., Chair, Insurance Corporate and Regulatory Practice Group, (212.908.1270, fsemaya@cozen.com), William K. Broudy, Esq. (212.908.1289, wbroudy@cozen.com), or Laurance D. Shapiro, Esq. (212.908.1363, lshapiro@cozen.com).